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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

v.

23 CV 1346 (JSR)

DO HYEONG KWON and TERRAFORM
LABS PTE LTD.,

Defendants.

Oral Argument

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New York, N.Y.
June 15, 2023
2:40 p.m.

Before:

HON. JED S. RAKOFF,

District Judge

APPEARANCES

DEVON STAREN
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1 (Case called)

2 MS. STAREN: Devon Staren for the Securities and
3 Exchange Commission.

4 MR. CONNOR: James Connor for the SEC.

5 MS. MEEHAN: Laura Meehan for the SEC.

6 MR. CARNEY: Christopher Carney for the SEC.

7 MR. HENKIN: Douglas Henkin from Dentons for the
8 defendants, your Honor.

9 MR. KORNBLAU: David Kornblau from Dentons, also for
10 the defendants.

11 MR. FARRELL: Charles Farrell from Dentons, also for
12 the defendants.

13 MS. LANDOW: Alyssa Landau from Dentons, also for the
14 defendants.

15 THE COURT: Good afternoon. Please be seated.

16 We are here to hear the argument on the motion to
17 dismiss.

18 Let me hear first from moving counsel.

19 MR. HENKIN: Thank you, your Honor.

20 Before I start substantive arguments, there is one
21 housekeeping matter I wanted to get your Honor's guidance on.

22 THE COURT: Hold on one second.

23 Good help is hard to find these days.

24 MR. HENKIN: Thank you, your Honor.

25 The housekeeping matter relates to the fact that it

1 has been kind of a busy week in crypto. There have been a lot
2 of developments this week that we think relate to the merits of
3 the motion, including the major questions doctrine, the
4 due-process argument that we made, and also the fair-notice
5 argument that we have made. These are developments that have
6 arisen quite literally this week, mostly on Tuesday in fact.

7 What happened on Tuesday was, there was a hearing in
8 the *Binance* matter before Judge Jackson in D.C. There was a
9 filing by the SEC in the *Coinbase* mandamus proceeding in
10 response to -- it's a very unusual order, but the best way that
11 I can explain it is, it was an order to show cause by the Third
12 Circuit that we think is relevant for your Honor to consider,
13 and there was also a very large unsealing of documents in the
14 *Ripple* case, including emails, internal SEC emails relating to
15 the drafting of the Hinman speech which, as your Honor knows,
16 plays a pretty significant role in the motion to dismiss.

17 These are all in the nature of supplemental support
18 for various of our arguments, but I didn't want to drop a
19 filing without your Honor's permission, and I also didn't want
20 to sandbag the SEC either.

21 So my suggestion --

22 THE COURT: I was busy Tuesday sitting on the Ninth
23 Circuit in Portland, so of course I didn't see any of this
24 because I had more important things to do.

25 Why is any of this relevant to a motion to dismiss,

1 which is based on the pleadings?

2 MR. HENKIN: It's relevant, your Honor, or they are
3 relevant, your Honor, because they all relate to the SEC's
4 position regarding its authority, and, in particular, with
5 regard to the Hinman speech, it shows you what the intentions
6 were.

7 I will give you one example of one of the emails.
8 There was an email from the Office of General Counsel at the
9 SEC during the drafting process for the Hinman speech that
10 basically confirms our reading of how *Howey* is to be
11 interpreted and that investment contract requires a contract.
12 So it all relates to and supports many of the arguments.

13 THE COURT: Maybe I'm still missing your point.

14 If someone at the SEC says, in my hypothetical, I
15 don't think this is a security, X, why would that matter to me?
16 I have to decide as a matter of law whether it's a security or
17 not based on the pleadings, yes?

18 MR. HENKIN: What you have to decide -- I think one of
19 the issues that you need to decide is how to interpret the
20 *Howey* test and whether the *Howey* test even applies.

21 So the first question is, under the major questions
22 doctrine, whether the *Howey* test even applies, whether the SEC
23 has demonstrated that it has the relevant authority from
24 Congress.

25 By the way, I left out one set of documents, which was

1 that, on Tuesday, there was a hearing of the House Financial
2 Services Committee in which there were -- and some
3 correspondence to the SEC from the -- from that committee
4 asking the SEC not to front run -- those are the committee
5 members' words, not mine -- Congress with respect to all of
6 this. These are issues --

7 THE COURT: Again, so what? Why does that matter to a
8 district judge who is determining whether or not, on the face
9 of the complaint, a case has been made as to whether these are
10 securities, etc.?

11 It might be nice to wait for Congress, although that
12 usually requires several lifetimes, but I am not sure why -- at
13 least I still don't see why it's relevance to me.

14 MR. HENKIN: From our perspective, it's a matter of
15 making sure that your Honor has the full record.

16 And this is an unusual case from the perspective of
17 the major questions doctrine because, for example, getting a
18 little bit into the merits out of order, but unlike, for
19 example, the *West Virginia* case that was decided by the Supreme
20 Court last year, there is a very different kind of record here,
21 and you've got a record developing.

22 We pointed to quite a bit of this in the briefing, but
23 it has developed further even since the close of briefing with
24 regard to what Congress actually thinks and what Congress has
25 requested that the SEC do and, more importantly, not do.

1 I will give you one example --

2 THE COURT: Go ahead.

3 MR. HENKIN: Just for example, in the briefing, we
4 cited some of the proposed rule making by the SEC with regard
5 to changing some definitions in Rule 3b-16 with regard to the
6 definition of an exchange, and one of the things that happened
7 was that members of the house requested that the SEC withdraw
8 that proposed rule making because, again, they were concerned
9 about the SEC not front-running Congress with regard to the
10 regulatory status here.

11 My point is, to just make as complete a record as
12 possible with regard to the major questions doctrine and other
13 things that we have asked the Court to decide, if the Court --

14 THE COURT: While I'm having difficulty seeing why any
15 of this is relevant to the instant motion, let's assume
16 hypothetically that it is. Do you want to supplement the
17 record, in which case we ought to postpone oral argument a day
18 or two, or do you want to go forward now without reference to
19 any of that stuff and then supplement it later, which seems to
20 me to be not a prudent way to go forward?

21 It seems to me the choice is yours.

22 MR. HENKIN: Your Honor, you actually kind of read my
23 mind. One of the things that I was going to suggest is
24 postponing the argument a day or so for exactly that reason, so
25 that your Honor can see this and so that the SEC can respond.

1 THE COURT: All right.

2 MR. HENKIN: That would actually be my preference,
3 because I do think this is important.

4 THE COURT: I'll hear from your adversary in a minute.
5 Let me see what we have on tomorrow afternoon.

6 THE LAW CLERK: Nothing, Judge.

7 THE COURT: How about 2:00 tomorrow afternoon?

8 MR. HENKIN: If you tell me to be here, your Honor, I
9 will.

10 THE COURT: I think it's particularly good to have
11 lawyers here before a three-day weekend, make them earn their
12 pay.

13 You would need to then send me tonight --

14 MR. HENKIN: Correct.

15 THE COURT: And the SEC would have to send me their
16 response by noon tomorrow. Then we could have a full record
17 where we meet at 2:00 tomorrow.

18 MR. HENKIN: That would be fine with me, your Honor.

19 THE COURT: What about that? Let me ask the SEC.

20 MS. STAREN: Your Honor, we object. We think that we
21 are all here. We are all ready to go forward today. We have
22 already had a number of delays and adjournments. And we don't
23 believe that any of these other cases have any impact or
24 relevance with respect to the motion --

25 THE COURT: I'm inclined to think you're likely right,

1 but I also don't see the harm in what is, in effect, a 23-hour
2 postponement so that there can be no question that the defense
3 got to put in everything they wanted to put in.

4 MS. STAREN: Your Honor, I am unfortunately
5 unavailable tomorrow, so I would not be able to be here.

6 I think that our position is that the defendants have
7 already made their arguments with respect to major questions
8 doctrine, Administrative Procedures Act, and due process. They
9 have already briefed it.

10 THE COURT: Where are you going to be tomorrow?

11 MS. STAREN: Your Honor, I'm in the D.C. office. I
12 will be going back home. I need to actually make a flight for
13 the long weekend. I have a funeral to attend.

14 THE COURT: Is there any time you could do it this
15 evening or early tomorrow?

16 MS. STAREN: Your Honor, I could stay tonight. I
17 could stay --

18 THE COURT: I can't imagine anything better than
19 staying overnight in New York. There are quite a few good
20 shows you could see.

21 MS. STAREN: I have enjoyed my overnight in New York.

22 I think we could stay for a couple of hours. I have a
23 6:00 train I am supposed to be --

24 THE COURT: Here is what I'm thinking. Obviously, if
25 you have to attend a funeral, that gets first priority.

1 If we did it at 9:00 tomorrow morning, would that
2 still be doable for you?

3 MS. STAREN: I was hoping to be able to make it back
4 tomorrow for my son's fifth grade graduation at 1:00. I know
5 it's something sort of silly.

6 THE COURT: That's not silly at all.

7 Let me go back to defense counsel. How early this
8 evening could you get in the materials that you want to
9 supplement?

10 MR. HENKIN: There are two that I only just received
11 while I was in the hallway, actually. I would say 5:00.

12 THE COURT: Let me ask the court reporter.

13 How about 8:00 tomorrow morning? Then you could still
14 make your train. How about that?

15 What time would you have to take a train tomorrow to
16 be at your son's graduation?

17 MS. STAREN: I think I would have to be on a 9:00
18 train to be back at Union Station by 12:30 to make it to his
19 1:00 graduation. That's assuming there is a 9:00 train.

20 THE COURT: Is there a flight you could take, or is
21 that not going to save you any time?

22 MS. STAREN: I don't know, your Honor. I would have
23 to --

24 THE COURT: Let me throw out a different possibility.
25 How about having the argument at 7:00 tonight?

1 MS. STAREN: That would work, your Honor. I think as
2 long as we get it done sometime this afternoon, evening, I can
3 stay and take an overnight train if I needed to get back.

4 THE COURT: I may be wrong. If I'm not mistaken, I
5 think the Yankees are not playing tonight, so I'm completely
6 free.

7 That would mean you could see their papers and either
8 you could put in a very short response or you can make an oral
9 response when we get together at 7:00.

10 Does that work for everyone?

11 MS. STAREN: Yes, your Honor.

12 MR. HENKIN: Your Honor, I will also endeavor to get
13 it in before 5.

14 THE COURT: Terrific.

15 I am going to miss you, but I'll see you at 7:00 this
16 evening here in this courtroom.

17 Thanks very much.

18 (Recess)

19 (Case called)

20 MS. STAREN: This is Devon Staren with the Securities
21 and Exchange Commission.

22 MR. CONNOR: James Connor for the SEC.

23 MS. MEEHAN: Lauren Meehan for the SEC.

24 MR. CARNEY: Christopher Carney for the SEC.

25 MR. HENKIN: Douglas Henkin for the defendants.

1 MR. KORNBLAU: David Kornblau for defendants.

2 MR. FARRELL: Charles Farrell for the defendants.

3 MS. LANDOW: Alyssa Landau for the defendants.

4 THE COURT: Good evening. Glad to have you back. You
5 may all be seated, and the further advantages, we lost most of
6 our audience. That's a good thing, of course.

7 I'm ready to hear argument from moving counsel.

8 MR. HENKIN: Thank you, your Honor. Thank you again
9 for the Court's courtesy with regard to allowing the
10 submissions and for doing this at this late hour. I will
11 endeavor to move quickly.

12 THE COURT: Take your time. I don't regard this as a
13 late hour. I'm a New Yorker.

14 MR. HENKIN: Your Honor, let me start by addressing
15 the major questions doctrine, which is both a substantive
16 limitation on agency power to address it as a basis for
17 dismissal.

18 The major questions doctrine, as it has now been
19 articulated by the Supreme Court, is the substantive limitation
20 on agency's power. It's also a guide for the Court in
21 addressing how to interpret agency assertions of what statutes,
22 in this case the '33 and '34 Act mean.

23 As the Supreme Court has expressed it as recently as
24 the *West Virginia* case in 2022, if an agency asserts that it
25 has the power to do something, that power has to be clear from

1 the statutory text.

2 We are in a situation here where with respect to
3 asserting that UST, LUNA, mAssets, and MIR token are
4 securities, the SEC is relying on two words in the statute,
5 those two words being investment contract. But the SEC only
6 wants to have one of them have any meaning. They want to treat
7 the word contract because, as we will discuss with respect to
8 each of the assets that are at issue here, there is no
9 contract.

10 THE COURT: I understand the arguments about whether
11 or not this is an investment contract.

12 I'm less clear as to why you think any of that is
13 subject to an exception under the major questions doctrine. I
14 think there are like five cases where that doctrine has been
15 applied, and they all seem much more extreme situations than
16 this.

17 Congress passed the Securities Acts because it wanted
18 to give broad regulation of the kinds of investments that had
19 resulted in the great depression. And if this is not an
20 investment contract, of course, that's a problem. But
21 assuming, for the sake of argument, that it meets the
22 definition of investment contract, why isn't that the end of
23 the major questions doctrine?

24 MR. HENKIN: I mean, that is getting to the
25 conclusion.

1 My point about the major questions doctrine is, when
2 you have a scenario -- and it's one of the reasons, for
3 example, that we put in Exhibit 9. If you look at comments A16
4 and A13, those are acknowledgements by a member or a then
5 member, I should say -- I don't know whether it's a current
6 member -- of the SEC's Office of General Counsel, that there
7 is -- that there was a regulatory gap in connection with
8 digital assets.

9 So the question that we are really talking about here
10 is, how do you interpret what an investment contract is? And,
11 more specifically, how do you interpret whether that definition
12 can be viewed as extending to assets that nobody could have
13 conceived of in 1933 and 1934 or 1946.

14 THE COURT: I'm not totally sure I understand that
15 argument as well, although I know there is language along those
16 lines in some of the major questions doctrine cases.

17 Take, for example, the Fourteenth Amendment or take
18 the mail fraud statute maybe. That's a better example, really
19 a precursor to the Securities Acts, and some of the language of
20 the Securities Acts comes right out of the mail fraud statute.
21 That was passed in, as I'm sure you remember, in 1872. They
22 deal very specifically with a particular fraud, so-called green
23 goods fraud, which is described in the original form of the
24 statute.

25 But it had broader language about any scheme or

artifice to defraud. And the Supreme Court forever now has repeatedly held that that is broad language. They have cut back the statute with respect when it went beyond money or property, for example. Just as you could cut back securities regulation, if this was not a security or an investment contract, or whatever, but they have never suggested that because something new comes up through new technology or new sales techniques or whatever, that's not covered by the mail fraud statute, and I don't see the difference with the securities fraud statute.

MR. HENKIN: I think one of the ways of thinking about the difference there is that the mail fraud statute that you are describing is conduct based.

THE COURT: That's not true. It's anyone who devises -- exact words are: Anyone who devises a scheme or artifice to defraud and then sends something through the mail; in execution of it, commits a crime.

MR. HENKIN: Right. That's my point. The words that you just described -- the words that you just used, your Honor, are a description of the conduct that would be deemed violative of the statute.

THE COURT: The jurisdictional element is the mailing. That's what gives you federal jurisdiction. But the fraud is the scheme or artifice to defraud.

MR. HENKIN: The other issue that distinguishes, I

think, the mail fraud statute here is that it's not -- we are not talking about a delegation of authority to an executive agency. That's what the major questions doctrine is about.

The question is, so when someone is trying to -- when the government asserts a mail fraud claim, for example, that is a DOJ prosecution, this is a situation where you have an agency asserting that certain things qualify under a definition in a statute where it's an enumerated definition in the statute. That's a delegation of power to an independent regulatory agency as opposed to a criminal statute.

The other thing, by the way, that distinguishes it is that you have the independent limit of the rule of lenity, which I suspect is where your Honor was going with the Fourteenth Amendment in connection with -- as a limitation on the criminal statutes.

In a sense, analytically, you can think of the major questions doctrine as the executive agency analogue of the rule of lenity.

THE COURT: That's intriguing. I don't want to get too far afield. It's hard for me to think of any actual Supreme Court decision which the rule of lenity was what made the difference in the result. The rule of lenity is usually see also. The usual Supreme Court cases in which that comes up are, we decide for the following reason X., and this is supported by the rule of lenity as well.

1 But we are not here to get that far afield, so go
2 ahead.

3 MR. HENKIN: Just to follow along as to why it makes
4 sense that this would be deemed a gap and, therefore, the SEC's
5 action here not permissible by the major questions doctrine, if
6 you think about the reasons the SEC typically asserts or the
7 purposes of the securities laws, they are to regulate
8 disclosure, and, in a sense, that goes to the issue of trust
9 within a system.

10 The thing that makes digital assets different from all
11 other types of assets that have gone before them is, if you go
12 back to the original Bitcoin white paper, it was the
13 elimination of trust from transactions. So what you have here
14 is a system in which the assets that the SEC is now attempting
15 to regulate using the investment contract catch-all phrase --
16 and the catch-all part is important. I will come back to
17 that -- are systems in which the need for trust has been
18 written out of them by design.

19 That's the whole point of digital assets. They are
20 trustless. That's why you hear names like -- things like
21 trustless proofs and things like that bandied about, which I
22 will not get into the weeds of. That is something that is a
23 very, very different type of asset, so needs to be looked at
24 carefully from the perspective of, does this fit into the set
25 of things that the definitions in the '33 Act and the '34 Act

1 of securities fit into.

2 The SEC's entire response --

3 THE COURT: Just because I want to be sure I
4 understand what was being sold here, and, as always in these
5 situations, you are faced with two difficulties: One, which is
6 of your client's making, which is the unusual language that
7 accompanies all this stuff. The other is the inherent age of
8 the federal judge you're in front of. The ancient is perhaps
9 an exaggeration.

10 As I understand it -- and this is why I want to make
11 sure I have it right. So you're a prospective purchaser.
12 Let's say your company was still going strong. You are told,
13 buy this coin for a dollar a coin, and you can then -- you can
14 just keep it as a coin and use it as a coin in other digital
15 purchases, or you can transfer it into what's called Anchor.

16 MR. HENKIN: Yes.

17 THE COURT: And then you will make a lot of money.

18 Do I have that right?

19 MR. HENKIN: Yes and no.

20 THE COURT: Yes and no. Oh, my God. You are a
21 lawyer.

22 MR. HENKIN: Your Honor, I remember our first meeting.

23 Your Honor started by using the word sold. That's a
24 really important place to start because these assets don't work
25 in the same way that, for example, a share of stock works where

1 it comes directly from, let's say, IBM, for the sake of
2 argument. We can get into the details of this with UST. UST
3 is the stable coin that a great deal of the complaint is about.
4 By design, it is to be pegged one to one to the dollar.

5 It's designed not to fluctuate, and we can talk about
6 the mechanism separately, but what it was was a stable coin.
7 And the purpose of that was for commerce, essentially a store
8 value or commerce. That's a consumptive use.

9 We have cited a lot of cases talking about where
10 courts have held that when you buy something, whatever it is,
11 so in this case it's one UST, when you buy it primarily for
12 consumptive use, that's not an expectation of profit. It's an
13 expectation of consumptive use. You probably saw in the briefs
14 that we talked about gold, for example. Some people buy gold
15 to use it. Some people buy gold to store value. Some people
16 buy gold to use it in transactions. It's kind of an
17 across-the-board thing.

18 THE COURT: If you're a federal judge, you can't
19 afford to buy gold, so there you go.

20 MR. HENKIN: I didn't check the price today.

21 That is a separate thing from the Anchor protocol.

22 One of the things that is very interesting is that the
23 SEC doesn't assert that UST -- let's just assume that we are
24 talking about the *Howey* test for now. I am going to jump
25 around a little bit just to respond to your Honor's questions.

1 Let's assume that we are talking about the *Howey* test. Part
2 one of the *Howey* test is -- one part of the *Howey* test is
3 expectation of profit. If what you are buying is a stable
4 coin --

5 THE COURT: Am I right that something like 75 percent
6 of the people did use the Anchor protocol?

7 MR. HENKIN: No. Actually, your Honor, what is pled
8 in the complaint is that at the time of the May 2022 de peg, 75
9 percent -- that's a snapshot. 75 percent of the outstanding
10 UST had been deposited in the Anchor protocol. UST predated
11 the launch of the Anchor protocol by seven months. There is
12 nothing pled in the complaint about how much UST throughout its
13 lifetime was used for consumptive or other purposes. It's not
14 in the complaint.

15 THE COURT: Again, bear with my ignorance. If the
16 complaint had said, we are only claiming it's a security for
17 those persons who deploy it in the Anchor protocol, when you
18 buy the coin, you may just stick with a coin, or you have the
19 option to go into the Anchor protocol, if it's limited to that
20 hypothetically, are you claiming that's not an investment
21 contract?

22 MR. HENKIN: Yes. Because the investment contract
23 is -- you'll notice that there is another thing missing from
24 the complaint. They don't -- the SEC doesn't allege that
25 anyone bought UST from Terraform labs, from any of the

defendants. There is no allegation to that effect. In fact, the allegations are that everyone who purchased UST did it through various marketplaces, trading platforms, some in the U.S., some not in the U.S. That's not spelled out. So there is -- these are all secondary market transactions.

What somebody then does with it -- and one of our arguments is the *Howey* test. It can't be an investment contract if it's acquired in a secondary market transaction. So if you go back to the facts of *Howey*, for example, the investment contracts were direct transactions with Mr. Howey's farm and its various associated businesses.

The orange groves themselves were not the investment contracts. The investment contracts were separate. Or if you look at the *Whiskey Cask* case that the SEC cites, which actually had more, I think, probably, than *Howey* did, the investment contracts were many and varied, but they weren't the whiskey casks themselves.

The decision to put something, the independent decision to deposit something, in this case, UST, into the Anchor protocol doesn't make UST an investment contract.

THE COURT: Trying to analogize it to *Howey* a little bit, supposing in my hypothetical you purchase an orange grove, but the terms of the purchase were either you can keep the trees and the oranges, or you can transform it, send it back, and get a share in the company that operates the orange groves.

1 Would that be an investment contract?

2 MR. HENKIN: The transaction itself might be, under
3 those circumstances, because now you are starting to come
4 closer to what actually happened in *Howey*. Remember, that in
5 *Howey* there were -- the way the Supreme Court describes it is
6 in terms of percentages. 85 percent of the people who bought
7 the land, I think there were 42 people, 85 percent of the
8 people who bought the land also entered into the management and
9 profit-sharing contracts, but 15 percent didn't. For those 15
10 percent, the purchase of the orange grove on its own, which
11 didn't have any of the strings attached like what you were just
12 talking about in your hypothetical, those were not securities.

13 THE COURT: That's why I'm asking you.

14 What I want to know from you is, assuming, for the
15 sake of argument, that the purchase of the NST coin itself was
16 not a purchase -- the government is going to disagree with that
17 in a minute, but assume that for the sake of argument. But
18 assume further that most people, however, don't stop there.
19 They use that because there is the added advantage, the option
20 to go into a profitable Anchor alternative where you are
21 guaranteed 18, 19 percent, or whatever it was, and that option
22 is only available to people that purchase the NST coin.

23 Is any of that then transformed into an investment
24 contract?

25 MR. HENKIN: No, your Honor. Because that's a

1 separate decision regarding the consumption or the use of the
2 UST tokens.

3 If I could give you an analogy or reverse analogy in
4 this case, one of the things that the SEC has said over the
5 years, although I think they are backing away from it now, is
6 that the utility of a token, meaning what you can use it for,
7 is something that could be determinative of whether or not a
8 token was a security. So one of the things that, at least
9 until a few years ago, was discussed significantly was whether
10 something -- a token that had utility, you could use it for
11 something, in this instance for Anchor, is a security, and the
12 SEC's answer has been no.

13 What your Honor is describing is essentially the
14 inverse of the utility token test, because UST -- the sequence
15 of events here is, UST becomes available, seven months later
16 the Anchor protocol becomes available, and that just presents
17 one option amongst many for anybody who had actually purchased
18 UST or was considering purchasing UST, but there are no package
19 deals and there are none alleged in the complaint.

20 THE COURT: For those people who take that second
21 step, are they purchasing an investment contract?

22 MR. HENKIN: No. Because you have to look at the
23 asset itself. And the asset itself was not a security at the
24 time it came into existence.

25 One way -- another way of thinking about this is to

1 look at the --

2 THE COURT: I am having a little trouble with that
3 answer.

4 Supposing you purchase -- I go back to the *Howey*
5 situation. You purchase an orange grove and then you are made
6 an offer, in my hypothetical, that if you are one of these
7 folks who owns an orange grove, you can give it back to us and
8 we will give you instead a share in our ongoing business, or
9 something like that.

10 You say those latter people would not be purchasing an
11 investment contract or a security?

12 MR. HENKIN: It would depend on what that exact offer
13 was. If it was, for example -- you would have to look at what
14 they were getting a share in. The transformational aspect of
15 what your Honor is asking I think is something that is
16 addressed by the *Marine Bank* Supreme Court case, which is not
17 one that has been cited by either side, but it is one that is
18 often cited by the SEC.

19 THE COURT: We can postpone this another three hours
20 and --

21 MR. HENKIN: This is something I am comfortable just
22 standing here talking about.

23 THE COURT: Very good.

24 MR. HENKIN: In the *Marine Bank* case, what happened
25 was, the plaintiffs, flipped parties when it got to the Supreme

1 Court, the plaintiffs purchased a certificate of deposit, a
2 six-year certificate of deposit. That was then pledged in a
3 separate transaction, I think about a month later, to secure a
4 loan to a separate company, and there was a request. It's all
5 detailed in the Supreme Court's decision.

6 And that deal, suffice it to say, and that -- the CD
7 was pledged essentially as collateral for the loan, in part.
8 And what went in part with that was kind of the share of the
9 business or a share in the profits exactly, as your Honor was
10 describing, and the Supreme Court said: No. That's not a
11 security. That's not an investment contract. Because the CD
12 was not a security itself when the two plaintiffs, husband and
13 wife, took it out or bought it from the bank, even though it
14 was in that case the same bank.

15 THE COURT: I have forgotten about that case. I'll
16 take a look at it.

17 MR. HENKIN: That I think is the answer to your
18 Honor's hypothetical about whether there can be some sort of
19 transformation of something that is not a security into a
20 security. It depends on the circumstances. But there is
21 nothing like that alleged here.

22 Essentially what the SEC has alleged is that the
23 availability of an application or, in this case, a use case,
24 for UST somehow made UST into a security, but that's not the
25 way the law can work or should work. I mean, it's essentially

1 time travel. That's the reason that the effect of Anchor is
2 not something that the Court should take into consideration. I
3 don't actually think that it's what the SEC has pled here.

4 THE COURT: I understand. My hypothetical went beyond
5 the terms of the complaint.

6 What else would you like to discuss?

7 MR. HENKIN: Let me just end the discussion on the
8 major questions doctrine by discussing the SEC's response,
9 which is that there is a difference from the perspective of the
10 major questions doctrine between enforcement and regulation.

11 I would respectfully disagree with that. I think the
12 Supreme Court has been quite clear in *West Virginia* that it's
13 about the exercise of power by an agency. Both enforcement and
14 rule making are exercises of power by an executive agency.

15 In fact, what I would suggest to the Court is that the
16 exercise of power by enforcement is more deserving of higher
17 scrutiny under the major questions doctrine than prospective
18 rule making, because the only way that a defendant or
19 defendants can address that is after the fact.

20 THE COURT: I understand that argument. I think
21 that's an important argument.

22 I want to go back, though, to the point I was sort of
23 raising with you earlier.

24 I am looking at, for example, *SEC v. Edwards*, 540 U.S.
25 389, a 2004 decision of the Supreme Court, which says:

"Congress' purpose in enacting the securities laws was to regulate investments in whatever form they are made and by whatever name they are called."

I'm looking also at the well-known case of *SEC v. C.M. Joiner Leasing Corporation*, 320 U.S. 344, a 1943 decision, that Congress "necessarily employed general descriptive terms like investment contract to ensure that the definition of security reached novel devices."

I'm also looking at the equally famous case of *Reves v. Ernst & Young*, 494 U.S. 56, that "congress painted with a broad brush precisely because it recognized the virtually limitless scope of human ingenuity, especially in the creation of countless and variable schemes," that last one all in reference to securities and mail fraud predicates through a RICO cause of action.

What about all that?

MR. HENKIN: With respect to all of those, your Honor, what I would say is, and I'll look at *Edwards* first because *Edwards* -- in *Edwards* there was in fact a contract.

And what's missing in this case is a contract. There are some contracts the SEC discusses, but they are private sales of LUNA tokens and MIR tokens, but there are no contracts that the SEC alleges between either of the defendants and any purchasers -- and any open-market purchasers of LUNA. That's an important thing because the contract -- the word contract

1 can't be read out of the definition. It's there. If you could
2 delete the word contract, all that would have needed to be said
3 in 1933 and '34 is investments, period. In fact you wouldn't
4 have needed the definition at all. Congress could have just
5 said investments. So contract has to have a meaning.

6 What I would say to your Honor is the two recent
7 Supreme Court cases, one being *Slack Technologies v. Pirani* and
8 the other being *Sackett v. EPA*, discuss in detail situations
9 where there are two words in a statute and somebody's proposal
10 is to read one of them out. And in both of them the Supreme
11 Court said: No, you can't do that as a matter of statutory
12 construction.

13 By the way, *Slack v. Pirani* was about the '33 Act in
14 fact. There is some discussion in that case. I'll just give
15 you the citation. It is number 22-200. It's a June 1
16 decision.

17 THE COURT: Investment contract in the securities laws
18 is a term of art. In *Howey* the Court says: "An investment
19 contract for purposes of the Securities Act means a contract
20 transaction or scheme."

21 In *Howey* and also in the Second Circuit's decision in
22 *Revak*, investment contracts are defined as "an investment of
23 money in a common enterprise with profits to be derived solely
24 from the efforts of others."

25 This is not exactly contract in the first -- in the 1L

1 sense. It's very broad. As the Supreme Court said in *Howey*,
2 it could include investment schemes.

3 MR. HENKIN: My response to that would be that I have
4 not seen a case, and I am not aware of a case -- let me back up
5 and say that I think the words after contract, so scheme or
6 artifice, are essentially dicta because I have not seen and the
7 SEC has not cited a case that does not involve an actual
8 contract in the privity sense, in the 1L sense, between the
9 defendants in whatever that case was and somebody who purchased
10 the token.

11 It's very interesting here that it's not -- this is
12 not a situation in which the SEC alleges that, for example --
13 and I am going to skip to the LUNA tokens because that's where
14 they do allege that there were private sale contracts, a small
15 number of them, and we can talk about the other issues with
16 regard to that. But there are no allegations that any -- let
17 me put it a different way.

18 What the SEC says is, and this is essentially a way of
19 trying to bootstrap into a secondary market transaction, that
20 those private sales were, in essence -- and that's the words --
21 those are the words that are used in the complaint -- were, in
22 essence, a public offering. That's how the SEC is trying to
23 get around the absence of a contract between anybody else who
24 bought LUNA tokens and the defendants. They are trying to say,
25 OK, well, what you did is, you sold some to these private sale

1 purchasers. We can talk about the arguments that we have made
2 about those separately, but what they are arguing is that that
3 was, in essence, a public distribution.

4 This is not like the *Telegram* case, for example, where
5 you had two offerings to a total of about 175 people, \$1.7
6 billion. There is nowhere near that much argued in terms of
7 the actual private sales here.

8 But the two sales, the two tranches of sales in the
9 *Telegram* case were very different. Before I actually get into
10 what the differences were, the defendants in the *Telegram* case
11 conceded that the first offering was an investment contract
12 because there was a direct -- there was direct privity between
13 Telegram and those purchasers, so there was a concession in
14 that case that the first tranche was a set of investment
15 contracts.

16 The difference between the two tranches were that the
17 first set of tokens were locked up for a period of time. They
18 unlocked at various stages. The second set of tokens was not
19 subject to a lock provision.

20 So what the SEC argued in that case was that the
21 second set, which was the only one where it was disputed as to
22 whether it was actually an investment contract, was an
23 investment contract and therefore a security because they were
24 able to be sold into the market immediately, and there was an
25 economic incentive to sell them into the secondary market

1 immediately.

2 The contracts here are different and the allegations
3 are different. Whereas there was an assertion that there was
4 an immediate economic incentive in Telegram on the second
5 tranche, there is no such allegation here and there can't be
6 because of the way the contracts -- the actual contracts for
7 the LUNA tokens were structured. It's the same thing with
8 respect to the MIR tokens. That's why we say that there is no
9 contract here for any of the tokens between any public
10 purchasers and any of the defendants.

11 The other thing that is important to note about all of
12 the cases that talk about these investment contracts is what
13 the contracts mean and what the contracts provide for, because
14 a purchase or a sale contract alone isn't enough. There has
15 got to be some obligation that runs from the seller to the
16 purchaser, an obligation to do something, to take action to
17 benefit whoever the purchasers are of whatever the asset is.
18 And there are no allegations here of that and there can't be
19 because there isn't something like the orange grove
20 maintenance, the picking contracts, or the profit-sharing
21 agreements.

22 There also has to be an allegation that there is an
23 entitlement to share in the profits of whatever the enterprise
24 is that forms the investment that is -- that is part of the
25 investment contract. It was obvious in *Howey* because there was

1 a profit-sharing contract in that case.

2 Here, there is no allegation that either of the
3 defendants made profits off of any of these alleged
4 transactions or that there was any right to share in whatever
5 monies TFL made, however TFL made them. That's why the
6 existence of a contract is so important.

7 I mean, to give an analogy, and I think this is one
8 way to harmonize the *Howey* reading of investment contract, with
9 the inclusion of stocks or bonds, for example, in the
10 enumerated definition of securities, that with respect to a
11 stock or a bond, there is some contractual right. With respect
12 to a bond, it's whatever the payment stream is. With respect
13 to a stock, it's the right to residual profits and/or dividends
14 and whatever else is in the bylaws, which are a contract with
15 the shareholders. That's how you harmonize them.

16 But the point is, in each case what the investment
17 contract term of art, as you put it, is standing in for is a
18 defined obligation from the entity that -- and issuer is an
19 interesting word here that I don't think applies in the same
20 way. But in those cases it's a defined obligation from the
21 issuer to the purchaser of whatever it is that is deemed to be
22 an investment contract. That's not alleged here.

23 THE COURT: I am sure there are things you wanted to
24 cover, but we have gone for about 45 minutes. I think we
25 should hear from your adversary, and then we will come back to

1 you.

2 She was so overwhelmed by your argument, she dropped
3 the papers.

4 MS. STAREN: Good evening, your Honor, may it please
5 the Court.

6 I'd like to bring this case back to what we have
7 alleged and what this case is about, which is defendants'
8 efforts to take advantage of U.S. markets, to promote, offer,
9 and sell billions of dollars of crypto asset securities to U.S.
10 investors while engaging in a scheme to defraud those investors
11 about core aspects of the business.

12 Defendants told investors that Terraform crypto assets
13 were fundamentally different from other crypto assets because
14 they were supposedly being used in real-world consumer
15 transactions on a Korean payment platform called Chai. In
16 fact, they were not. This was false and defendants knew it.
17 Defendants also misled --

18 THE COURT: Although they make an argument, which we
19 have not discussed, about, they claim insufficient allegations
20 of fraud, an argument that I'm frankly skeptical of their
21 argument in that regard, but it's not a focus right now.

22 They are saying their more fundamental arguments are
23 that even assuming there were fraudulent representations made,
24 or whatever, they are not something the SEC can do anything
25 about, either because of the major questions doctrine or

because of the proper definition of investment contract.

That's where I want you to focus your remarks.

MS. STAREN: Sure, your Honor.

Obviously, we have spent a fair amount of time talking about the major questions doctrine.

Let me just remind the Court that in the *West Virginia* case, the Supreme Court held that the major questions doctrine limits agency authorization to promulgate certain extraordinary rules that would intrude on Congress' power to enact laws.

We are not promulgating any new rules, extraordinary or otherwise, or taking any action that was not authorized by Congress. We are simply alleging that the five crypto assets at issue in this case were promoted, marketed, offered, and sold as securities. Four of them were offered as investment contracts. One of them, the transactions involving the mAssets were security based swaps.

Every argument that the defendants have made, including the major questions doctrine, due process, and the Administrative Procedures Act, seems to be based on some false premise that we are enacting some new SEC policy to regulate all crypto assets as securities.

What the defendants are really asking for, your Honor, is special treatment. They would like this Court to find that crypto assets are exempt from the securities laws, that crypto assets are exempt from the definition of a security as defined

by Congress in the 1933 and 1934 Acts, exempt from the same investment contract analysis that has been applied across a range of technologies, industries, and businesses since *Howey* was decided in 1946.

Your Honor, we do not agree. The investment contract analysis has been applied to cattle embryos, to basketball NFTs, to certificates of deposits, pay phones, condominiums, supersonic dental products, and whiskey barrel receipts. There is nothing special about the asset.

The question, when you are evaluating whether something is an investment contract, is how it was offered, marketed, promoted, and sold.

THE COURT: All right. That's what I want to focus on because -- and I don't mean to pass over their important arguments on other matters. But why is this a contract, let alone an investment contract?

MS. STAREN: Your Honor, we disagree with the defendants. We don't believe that there is a requirement of a formal contract, as your Honor correctly pointed out. *Howey* itself expressly applied the investment contract analysis to any contract, transaction, or scheme. I would also --

THE COURT: Funny use of words, however. There is that language in *Howey*, but, on the other hand, the actual term in the law is investment contract. So how can a scheme, for example, be an investment contract unless it's a scheme to

1 promote an investment contract?

2 MS. STAREN: Your Honor, I think that the -- again,
3 the focus sort of goes back on what is an investment contract.
4 And, again, it goes back to how it is marketed, offered, and
5 sold. What are the promises, understandings, inducements,
6 expectations, and economic realities that surround the offer of
7 the asset.

8 As I mentioned, the investment contract analysis has
9 been applied to a range of assets. In every situation, the
10 asset itself is virtually irrelevant. You can offer gold or
11 coins or cattle embryo, which in and of themselves are not
12 securities. But when you offer them in conjunction with a
13 promise of the potential for profits, and you offer them as an
14 investment in a common enterprise, and the expectation is that
15 the investors will get their returns from the efforts of the
16 promoters or the efforts of others, then you have an investment
17 contract, and it doesn't really matter.

18 THE COURT: If I purchase a NST coin for a dollar a
19 coin and all I'm being told immediately in my hypothetical is,
20 we will make sure that it's always kept at a dollar, so you can
21 use it to buy anything you want digitally, and you won't have
22 to worry that it will be worth only 95 cents. It will be worth
23 a dollar.

24 Is that alone an investment contract?

25 MS. STAREN: No, your Honor. I think --

1 THE COURT: What makes this then an investment
2 contract?

3 MS. STAREN: What makes UST an investment contract is,
4 again, the way that it was marketed, offered, and sold. And it
5 was offered and marketed as a way to invest in the Anchor
6 protocol.

7 And, your Honor, the defendants are correct, that the
8 Anchor protocol didn't necessarily exist at the time that the
9 defendants started to market UST together with the Anchor
10 protocol. But it is a review that that actually doesn't
11 matter.

12 Because when you evaluate an investment contract, what
13 you are evaluating is, what were the promises being made to the
14 purchaser of that asset? If they were being promised the
15 potential for profits, a reasonable expectation of profits that
16 would derive from the efforts of others, then it is an
17 investment contract at the time that offer is made, even if the
18 ultimate thing doesn't exist.

19 THE COURT: I hear what you are saying. Translating
20 it into the facts of this case, are you saying that what made
21 these purchases of crypto coins an investment contract was the
22 promise that you could utilize them to make a profit through
23 the efforts of others by deploying them into other names, for
24 lack of a better word. Is that the basic argument? Do I have
25 that right?

1 MS. STAREN: With respect to UST, yes. It was the
2 promise that if you buy UST, you will have an opportunity to
3 stake it in the Anchor protocol and get up to 20 percent
4 returns.

5 THE COURT: I thought you had alleged that that's what
6 most people did, although your adversary seemed to be
7 suggesting some nuance there.

8 MS. STAREN: We did allege, just because you can only
9 pick a number from a particular point in time. We picked the
10 number that existed at the point just before the Terraform
11 market crashed in May of 2022. At that point in time,
12 approximately --

13 THE COURT: Of course on a motion to dismiss I have to
14 take every reasonable inference in your favor, so the inference
15 would be that's what most people did.

16 MS. STAREN: Yes, your Honor. Although, let me just
17 be clear, that the evaluation of what the expectation was is
18 not necessarily based on what any individual investor may have
19 intended at any point in time. We think that's an important
20 data point.

21 THE COURT: That's fair enough. But aren't you also
22 arguing that, nevertheless, the fact that most people did do
23 this showed their understanding from the getgo that this was
24 really an investment?

25 MS. STAREN: Yes, your Honor.

1 THE COURT: Go ahead.

2 MS. STAREN: I'd like to go back and talk about the
3 other tokens at issue here.

4 Obviously, UST, we did allege that it was marketed
5 together with the Anchor protocol and could earn up to 20
6 percent returns. This was actually a huge motivating factor
7 for a number of retail investors. Countless retail investors
8 bought in and ended up losing the bulk of their investment when
9 the Terraform market crashed in May of 2022.

10 The same analysis applies to LUNA. LUNA is an
11 investment contract because it involves an investment in a
12 common enterprise with an expectation of profits to be derived
13 from the efforts of others. Specifically, we would point to
14 statements made by Do Kwon to LUNA holders on Twitter where he
15 tells people that LUNA grows as the ecosystem grows, quote, and
16 that to profit, a LUNA holder could simply, quote, sit back and
17 watch me kick ass.

18 And the same goes for the MIR token. Defendants told
19 investors that MIR tokens would increase in value as the Mirror
20 protocol increased, and defendants promised investors that they
21 would support and promote the Mirror protocol in order to
22 generate that demand.

23 Moving on to the unregistered offerings, your Honor,
24 we have clearly alleged that the defendants engaged in a public
25 offering of its securities.

1 With respect to the initial sales of LUNA to the
2 intermediaries and the initial sales of MIR, there was a clear
3 expectation that those intermediaries would turn around and
4 resell into public markets. In fact, Kwon told a group of
5 investors, as we laid out in your complaint, that his purpose
6 in loaning LUNA to the U.S. trading firm was to, quote, improve
7 liquidity of LUNA. And in fact that U.S. trading firm did
8 exactly that. It turned around and it resold that LUNA into
9 public markets.

10 The agreements themselves, as we made clear in our
11 complaint, contemplate a public trading market. It is clear,
12 based on that language, that the parties to those agreements --
13 Terraform, Do Kwon, and the intermediaries -- intended that
14 they were going to turn around and resell those LUNA and MIR
15 into public trading markets.

16 Second, Terraform directly sold MIR and LUNA into
17 trading platforms, publicly accessible crypto asset trading
18 platforms. They made no restriction. They put no restriction
19 on those trades. They put no restriction on who could purchase
20 those. And they were accessible to U.S. people.

21 Finally, Terraform directly sold MIR and the
22 transactions involving mAssets to the public. They offered it
23 to the public. They sold it through a website that they
24 controlled. Those are all public offerings. None of them
25 contain any restriction. It was fully expected that the tokens

at issue would end up in a hands of retail investors on public trading platforms, and they made no efforts to restrict those sales, either from retail investors or from U.S. markets.

Your Honor, I know that you didn't want to spend much time on it, but just to mention, the defendants' challenges with respect to our fraud allegations are merely improper disputes over the facts, which are not appropriate on a motion to dismiss. We believe that the defendants' motion to dismiss should be denied.

THE COURT: Let's hear, in rebuttal, from moving counsel.

MR. HENKIN: Thank you, your Honor.

Let me address -- I am going to try to go in order, although I will mix things up a little bit.

All of the cases that the SEC's counsel described -- the embryo cases, the condominium cases, the CD cases, the whiskey cask case -- all of those were situations where something was managed by somebody else. Just like the orange groves and *Howey*. That's the common thing that ties all of those cases together and it's the common thing that gives meaning to both words of investment contract.

The tokens here, and particularly UST, because this goes to the Anchor argument, are very different because in all of the cases that were --

THE COURT: Aren't they managed by someone else in the

1 sense of -- as I understand how it is supposed to work, to keep
2 it at a one dollar value, the various things had to happen, all
3 of which were managed by the sellers.

4 MR. HENKIN: No. That's wrong, your Honor.

5 If you look at the various documents, including the
6 Terra white paper, that's Exhibit A, for example, that
7 describes how the protocol works, the balancing protocol
8 between UST and LUNA. In that case there is separate white
9 paper for the Mirror protocol that describes how that works.
10 We can talk about that in more detail because those are
11 separate issues.

12 All of those are situations in which the -- there are
13 two parts of this. There is the algorithm, which is run by
14 smart contracts on the Terra blockchain, so it's automatic in a
15 sense.

16 THE COURT: Let me just pause there. No algorithm is
17 automatic in the sense that it exists in nature. It's designed
18 by someone and all sorts of inputs go into it, and the person
19 designing it in this case was you, right, your clients?

20 MR. HENKIN: It is true that algorithms are designed,
21 but it is also true that when this -- the algorithm here or the
22 blockchain became operational, control over it was turned over
23 to the community.

24 So one of the things that LUNA tokens do is, they
25 function as -- I am going to try not to get into the weeds --

they function as the mining and governance token of the Terra blockchain. What that does is, it makes determinations as to who is entitled to vote on, for example, how the system operates.

It's true that the original algorithm was coded by TFL, for example. But once it went into operation, it was operated by the community, and that is a very different thing than the situations like the whiskey casks, which were always kept in the custody of the company that sold them, I think that was the Ayers case, and the condominiums where somebody doesn't take possession.

The difference between all of those cases and this situation with respect to tokens is that purchasers of tokens take possession of those tokens and then decide what to do with them. And in situations like this, and I will --

THE COURT: Your adversary says what they are being offered is, among other things, they can use them to get an investment of guaranteed return of 18 or 19 percent or whatever it was, 19 to 20, by deploying them into Anchor.

So what about that?

MR. HENKIN: The point about that, your Honor, is that that's a choice and it's a separate choice, and I want to go to the tweet that Ms. Staren talked about where she said that Mr. Kwon said: You can sit back and watch me kick ass. There were two other parts to that tweet. You could sit back and

1 watch me kick ass, number two; and the third was, you can
2 participate in the community and build decentralized
3 applications that add value to the ecosystem.

4 The point about all of this is that in each instance,
5 once the token had been purchased, there was a choice that was
6 inherent -- two things. One, it was in the possession of the
7 purchaser and, two -- unlike all the investment contract cases
8 that have been cited; two, there was a choice about what to do
9 with it: Use it for consumptive purposes, stake it in Anchor,
10 stake it as a validator, so that you can participate directly
11 in the operation of the blockchain network, all sorts of other
12 decentralized applications that were available as well.

13 The SEC ignores that choice.

14 THE COURT: Let me just make sure I understand what
15 you are saying.

16 You are given several choices if you purchase, but
17 these are choices only available to those who purchase. The
18 NST coin. One of the options that is then available is an
19 investment option. Why isn't the offer then of the coin that
20 includes, but is not exclusively limited to, that option an
21 offer of an investment contract?

22 MR. HENKIN: Because there is no difference between
23 that and the choice that one has when you have a dollar bill or
24 a bank account. When you have one dollar, you can choose it to
25 buy -- let's make it more reasonable. Let's say you have \$100.

You could choose to buy maybe a share of stock. You can use it to buy \$100 face value of a bond. You can leave it sitting in a bank. You can use it to buy food. You can use it to buy all sorts of other things.

THE COURT: But the particular investment here is not something that anyone with a dollar bill can take a dollar bill and get; it's only someone who has purchased the NST coin, right?

MR. HENKIN: The UST coin.

THE COURT: Yes. I'm sorry. My acronyms are in bad shape.

Without that first step, you can't invest in the second step.

MR. HENKIN: There is no difference between that scenario and the scenarios in all the other investment contract cases.

I can take your Honor's hypothetical and say, the opportunity to enter into the contracts with Mr. Howey's orange grove management company and picking company were only available to the people who purchased the orange groves from Mr. Howey. That doesn't mean that the orange groves were securities. In fact, the Supreme Court specifically said they weren't, and that has been the SEC's internal understanding of the *Howey* test ever since. The orange groves aren't securities. It's the combination with a very specific offer

1 where there is a contract and obligations running from the
2 offeror to the purchaser that can create an investment
3 contract. That's missing here.

4 You will notice, by the way --

5 THE COURT: Let me ask a different kind of question.
6 Assuming for the moment that most people then put their -- went
7 into the Anchor alternative.

8 MR. HENKIN: An alternative to Anchor?

9 THE COURT: No. Went into Anchor.

10 Is it not enough to say that was the expectation of
11 the defendants, that's why they made it so attractive with the
12 guaranteed return and all like that, so that the fact that
13 there were some people who didn't take that is neither here nor
14 there.

15 MR. HENKIN: No. Because, your Honor, what that does
16 is, it separates a choice of what to do -- a choice of what to
17 do with something that's a consumable from the consumable
18 itself, or actually what I should say is, it compresses the
19 choice with the consumable itself.

20 Here, what you have -- by the way, I want to go back
21 to a point your Honor was discussing with Ms. Staren about the
22 snapshot. We are in a very interesting sort of a case here,
23 not just for all the reasons that we have been discussing, but
24 for two other reasons. One is that --

25 THE COURT: If it weren't interesting, I wouldn't be

here at 8:00.

MR. HENKIN: I hope I'm holding your Honor's interest.

THE COURT: Definitely.

MR. HENKIN: The SEC conducted an investigation for a little under two years here before bringing this case. And the system that we are looking at is open-source software, operating on publicly accessible blockchain.

So Ms. Staren made the comment in response to your Honor that they had to pick a number. I would disagree with that, and I don't think your Honor needs to accept that for the purposes of this motion to dismiss for the reasons that are set forth in the cases that we cited in which SEC enforcement actions were dismissed.

The SEC could have looked at the blockchain, could have looked at the usage of the Anchor protocol, could have made other arguments with regard to that. They picked the snapshot number.

Your Honor only has to draw reasonable inferences under *Iqbal* and *Twombly*. It doesn't have to draw every inference that the SEC would like. That's particularly true when the SEC has had time to investigate. That's a separate category of cases. And we have cited several of them in which --

THE COURT: Let's take a much more extreme example, but just to make sure I understand your argument.

1 Supposing I say to you, please buy my crypto coin, and
2 if you buy it, it will remain stable, and you can just leave it
3 as is and do what you want with it, but you will also have the
4 option that will only be offered to you, the purchasers of this
5 crypto coin, to invest in an investment where I will guarantee
6 you a million-dollar return in two months.

7 Putting aside the absurdity of that promise and, lo
8 and behold, in my hypothetical 99 percent of the people then
9 elect the option, the second option, is the fact that
10 theoretically there was still the option available keeping just
11 the coin enough to take the whole situation out of the coverage
12 of the SEC?

13 MR. HENKIN: Yes, I do. I think, your Honor, *Howey*
14 answers that directly because the coin that you are talking
15 about in your Honor's hypothetical -- it is just that the
16 numbers are different -- is the same as the orange groves and
17 *Howey*. What the Supreme Court very clearly said was, the
18 orange groves were never securities. The only thing that was
19 the security, or the investment contract in that case, was the
20 package deal. It may very well be that the package deal that
21 your Honor is talking about could be a security.

22 THE COURT: Let me then ask you this. Even assuming
23 for the sake of argument you're right about that, wouldn't that
24 simply require a narrowing of this complaint, not the dismissal
25 of the complaint, because the complaint encompasses at least

1 all those folks who then went and elected the investment
2 option?

3 MR. HENKIN: No. And the reason for that is -- there
4 are several reasons for that. One is that it doesn't change --
5 it doesn't make UST a security. You will notice no -- and the
6 SEC talked about an offer or a promise. There is no offer
7 alleged here. Essentially, what is alleged here is that
8 amongst the things that could be done with UST after it had
9 already come into existence was that it could be used in
10 Anchor, but that doesn't make UST itself a security.

11 THE COURT: Why isn't that an offer? Buy my coin and
12 you will have the following three options.

13 MR. HENKIN: Because -- and this is what I was
14 discussing earlier -- there is no allegation that anyone
15 purchased UST from Terraform labs. The SEC is very careful to
16 say, to allege that everybody who purchased UST purchased it on
17 a secondary market. So what's actually alleged in the
18 complaint is people making transactions on secondary markets
19 purchasing UST, and then seven months after UST first becomes
20 available, some of them deciding to use it in the Anchor
21 protocol when the Anchor protocol became available.

22 You will notice that there is not a separate
23 allegation that the Anchor protocol is a security. The SEC has
24 alleged in some cases -- *Celsius*, for example, or *Gemini*.
25 *Gemini* is probably the better example -- that certain earnings

1 programs were securities offerings, were investment contracts.
2 That's not alleged here and they have not asked to amend.
3 That's a very important aspect of this.

4 Essentially, I go back to, how does the option,
5 because that's really what it is here. It's not an offer.
6 It's an option. How does the option make something a security?
7 The answer is, it doesn't. It especially doesn't when the
8 option arises after the creation of whatever the asset is.

9 One example by analogy --

10 THE COURT: Who created that option?

11 MR. HENKIN: Who created the Anchor protocol?

12 THE COURT: Yes.

13 MR. HENKIN: Terraform did.

14 THE COURT: I'm having a little trouble seeing why
15 that -- assuming for the sake of argument that that was an
16 investment, that's not a secondary market in the sense of, we
17 are talking about the application to the securities laws here.
18 It's something you created, that only people who had taken this
19 first step could take advantage of.

20 Now, I agree with you that there are allegations, take
21 a broader picture of that, and that may be a problem for them.
22 But I don't see why that's not a securities contract at that
23 point.

24 MR. HENKIN: It's not a securities contract because
25 it's not a contract with TFL. This, again, gets into the

operation of the protocol. When somebody makes a deposit or when somebody made a deposit into the Anchor protocol, that was a contract with the protocol itself, if you can call it a contract. It was a deposit. It was governed by various of these computer programs that were governed by the Anchor community. So that in and of itself is not an investment contract, and the SEC doesn't allege that it was.

Here, if I can give your Honor an analogy.

THE COURT: Yes.

MR. HENKIN: Suppose that I were, and I wish I would do this, but suppose I were to invent a new use for gold tomorrow that generated returns for people, and I offered it into the market and said: If you have gold, use it in this process and you will make a lot of money. That offer that I would make might be an investment contract, but it wouldn't make gold a security, and that's really the distinction that's being made here or that needs to be made here because --

THE COURT: Wouldn't the proper analogy be, give me your gold, because I promise that this new process will transform it into lead. And that entire arrangement would be limited, if we carry out the hypo, to people whose gold was purchased from me, right, from the same seller?

MR. HENKIN: That's one way of creating the hypothetical, your Honor. It's not the only way. I think your Honor -- I think your Honor was looking for the most extreme

1 example. The most extreme example would be, I create a
2 process. I obviously don't make gold. I think we can all
3 agree on that. And I make the offer --

4 THE COURT: Although, as any many evilists would know,
5 who knows what you will come up with tomorrow.

6 MR. HENKIN: Let's say I come up with the lead-to-gold
7 process and I say, give me your lead and I will transform it
8 into gold. Under those circumstance, because the lead is a
9 naturally occurring element, that is not something that changes
10 lead into a security. It may very well be that the deal that I
11 offer under those circumstances could be construed as some sort
12 of an investment contract, but it doesn't change the fact that
13 the lead is still lead, which is a commodity in that instance.
14 This is a circumstance --

15 THE COURT: I think we probably pushed this analogy as
16 far as we can, but that's helpful.

17 Go ahead.

18 MR. HENKIN: I think what I should probably do now is
19 talk about the Mirror protocol. We have talked about -- let me
20 talk about LUNA just briefly. LUNA is not a security for the
21 same reasons that UST is. There is no expectation or profit.
22 It was designed as the native governance token for the Terra
23 blockchain. Nothing about Anchor changed that.

24 If you look at the white paper, it explains very
25 clearly what the function of LUNA was. It represents -- my

1 apologies for the technical term -- mining power on the Terra
2 blockchain, which is a proof-of-stake blockchain. And miners
3 who wanted to mine transactions would stake their LUNA and they
4 would get rewards for doing so. That's on pages 5 through 7 of
5 Exhibit A.

6 Now, let me talk about the Mirror protocol and the
7 mAssets because those are different.

8 Essentially, what the SEC alleges is that mAssets are
9 securities-based swaps. And there are multiple reasons why
10 they are not securities-based swaps, from a definitional
11 perspective.

12 As your Honor will recall, swaps have counterparties
13 and swaps contemplate the exchange of cash flows. An interest
14 rate swap fixed for floating, for example, contemplates
15 settlement on a periodic basis of cash flows paid by one payer
16 to another payer, depending upon what's going on in the markets
17 that month.

18 But the main point is, there is a counterparty to each
19 swap. That's not the way mAssets operate. The Mirror white
20 paper, which is Exhibit I, explains how they operate. What
21 happens -- essentially, the Mirror community determines what
22 mAssets are what's known as white listed, meaning allowed to
23 exist and allowed to be traded.

24 How does that happen or how did that happen? People
25 would make proposals to the community that could be voted on by

1 anybody who had MIR tokens. If somebody wanted to mint an
2 mAsset, let's say it was mGold, for example, because that's one
3 of the ones that was available, then they would interact with
4 the protocol, deposit cryptocurrency into the protocol, and
5 they would get the asset -- they would get the mAsset back.

6 What's important about that is that there is no
7 counterparty with whom they would be exchanging cash flows.
8 Although the price of the mAsset in this case, mGold, would
9 fluctuate with the reference price of gold. That's a
10 programmatic -- automatic feature of the protocol. It's done
11 by operation of the protocol. There is not a person -- there
12 wasn't a person at TFL who matched prices or did things like
13 that. The price would change.

14 And to the extent there was a price fluctuation when
15 somebody held an asset, they didn't get a payment if it
16 increased in their favor. They didn't pay something extra if
17 it decreased, if it went against them.

18 The only way they would realize that price difference
19 or that price change was by selling the mAsset -- there were
20 two ways. One was by selling the mAsset to somebody else in a
21 peer-to-peer transaction. That's not something that involved
22 TFL because it just happens on the blockchain on a peer-to-peer
23 basis, or by sending the mAsset back to the protocol and
24 burning it and getting back their collateral. That's the only
25 way that works. These aren't swaps under the SEC's own

1 definition of swaps.

2 THE COURT: OK.

3 I know there are many other issues and, of course,
4 your paper covers the full spectrum, but I think, since we have
5 now gone about almost an hour and a half, we should hear final
6 remarks from your adversary.

7 MS. STAREN: Thank you, your Honor.

8 I'd like to point out that, obviously, the SEC and the
9 defendants have a different view of the facts. We have a
10 different view of how these assets were being offered, how they
11 were being promoted, what the understanding --

12 THE COURT: For purposes of this motion, of course, I
13 have to take what's alleged in the complaint.

14 MS. STAREN: Thank you, your Honor.

15 That is what I was going to return to and just make
16 sure that it is understood that we have alleged that, with
17 respect to UST, it was marketed, offered, and sold together
18 with the Anchor protocol. That was the motivation. That was
19 why people bought UST. It can be analyzed objectively based on
20 what defendants told the market. They told the market that UST
21 was an opportunity to get those 20 percent returns.

22 Whatever other possible hypothetical consumptive use
23 that may or may not have existed, number one, we didn't allege
24 it in the complaint, so it's not relevant; and, number two,
25 courts have held that you can have some consumptive use. The

point of the investment contract analysis is to look at, what were the objective motivations. What were defendants telling investors and the public about what they would get by buying this asset.

THE COURT: There is both the subjective and the objective aspects. The objective one is, having heard this, how would a reasonable investor interpret it or reasonable purchaser.

MS. STAREN: Absolutely, your Honor.

THE COURT: And then the subjective, which is clearly not before me on this motion, is, did the defendants intend for that allegedly misleading perception or that alleged invitation to invest in a dubious investment? Did they intend that for fraudulent purposes? That kind of issue we don't get to until much later in the case.

MS. STAREN: Yes, your Honor.

I actually wanted to point out too, because it seems like there is actually something that we agree on, the defense and the SEC, and that is that these crypto assets alone are not investment contracts. We don't say that LUNA -- by itself, without an offer, without a promise, without an expectation of profits, LUNA, by itself, is just a piece of code. We don't believe and we don't allege that LUNA alone is an investment contract.

As I mentioned before, the analysis is looking at the

entirety of the scheme, the totality of the circumstances, how was it offered, and that's where we come to our difference. We believe that the way these UST together with the --

THE COURT: I do understand that, although of course I'm terribly distressed to know there is something that you and your adversary agree on. What happened to the adversary system.

MS. STAREN: I always try to find places where we can agree.

One thing I did want to point out, though, is I think that there is a misunderstanding with respect to our allegations involving the mAssets. I do want to clarify that our allegation is not that the mAsset itself is the security-based swap.

As we alleged in paragraph 102 of our complaints, it is that each transaction offering or selling an mAsset is the security-based swap. I recognize some of the issues that the defense counsel raises with respect to trying to say that the mAsset itself is the swap, but the transaction is because the transaction does involve the investor having to deposit collateral and getting an exchange of payment on an executory basis. They have to deposit more collateral as the value of that underlying asset increases. And the collateral is based on the value of a single security and the financial risk of that security is transferred to that investor without actually

1 transferring ownership of the security. And the risk, of
2 course, comes in the form of having to deposit additional
3 collateral if the value of the mAsset goes up. I just wanted
4 to make that clarification for your Honor and make sure the
5 record was clear there.

6 Finally, I think that I just want to get back to the
7 fact that we are not doing anything new here. We are not doing
8 anything complex. We are not doing anything novel. We are
9 simply applying the securities laws as they have been in
10 existence since the 1933 and 1934 Acts, evaluating investment
11 contracts, as they have been consistently and repeatedly
12 evaluated and analyzed in a range of transactions, businesses,
13 industries, technologies, including certainly a variety of
14 technologies that did not exist at the time *Howey* was decided
15 in 1946.

16 And nothing we are doing is new. It's absolutely
17 authorized. We are acting pursuant to clear congressional
18 authority and consistent with cases that we have brought.

19 I would add, your Honor, one thing I didn't add to my
20 list of technologies to which the investment contract has been
21 applied is in fact crypto assets.

22 I know that defense counsel raised the *SEC v. Telegram*
23 case in which the Court there found that the crypto assets were
24 offered and sold as investment contracts. Those cases have
25 been coming down around the country.

1 In *SEC v. Kik*, of course the Southern District there
2 found that the crypto assets were offered and sold as
3 investment contracts.

4 In *SEC v. LBRY*, the District of New Hampshire found
5 that the crypto assets there were offered and sold as
6 investment contracts.

7 In *SEC v. NAC Foundation*, the Northern District of
8 California found that the crypto assets there were offered and
9 sold as investment contracts.

10 Again, what we are doing is not new, novel, complex.
11 We are just applying the securities laws as they are today, and
12 we believe that the motion to dismiss should be denied.

13 THE COURT: I want to thank both counsel. This was
14 very helpful argument and certainly educated the Court much
15 more to the operation of the various options involved.

16 I want to make sure that I get you a decision
17 promptly. I found it very useful to set time limits on myself,
18 but there are quite a few issues here that I need to think
19 about.

20 I will guarantee you an opinion and decision by July
21 14, about a month from now, which is why I picked it, although
22 I could have also picked it in honor of Bastille Day.

23 I didn't bring the case management plan with me. If
24 there are things that need to be adjusted in the case
25 management plan, then give me a call. We don't have to deal

1 with that today, but give me a call. We will work around it.

2 There is also the possibility, if I have reached a
3 decision, even though I have not yet reduced it all to writing,
4 I could give you a bottom-line order even sooner than July 14,
5 but I think, in a case of this nature, it would be better to
6 give you the opinion at the same time that the decision is
7 made. You will know exactly how the Court reached its
8 decision. July 14, if not sooner, but no later than July 14.

9 You still have time for Turner Movie Classics and all
10 sorts of fun things, but I thank all counsel again. The Court
11 will take the matter under advisement.

12 (Adjourned)

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